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**REBUTTAL TESTIMONY OF**

**JOHN S. BEIER**

**ON BEHALF OF**

**SOUTH CAROLINA ELECTRIC & GAS COMPANY**

**DOCKET NO. 2009-2-E**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION.**

A. My name is John S. Beier. My office is located at 1426 Main Street, Columbia, South Carolina, and I am currently employed as Gas Asset Representative for SCANA Services, Inc. ("SCANA Services").

**Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND BUSINESS BACKGROUND.**

A. I am a 1992 graduate of the University of South Carolina, where I received a Bachelor of Science Degree in Accounting. Following graduation, I worked for a year and a half in public accounting with the CPA firm C.C. McGregor and Company. I am a licensed Certified Public Accountant in the State of South Carolina and am currently a member of the American Institute of Certified Public Accountants and the South Carolina Association of Certified Public Accountants.

In January 1994, I joined SCANA Energy Marketing's Financial Accounting Department. The following fall I began working with SCANA Energy Marketing's Director of Risk Management in hedging the natural gas reserves for SCANA's unregulated oil and gas subsidiary. In the summer of 1995, I accepted the position of

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1 Risk Management Analyst for South Carolina Pipeline Corporation ("SCPC") and  
2 conducted that Company's hedging program until December 1999. Over the next  
3 four (4) years I served as Supervisor of Gas Accounting and Regulatory for SCPC,  
4 and in 2003, I joined the department within SCANA Services responsible for natural  
5 gas supply. Since that time I have been responsible for administering a Commission  
6 approved hedging program for SCE&G's firm natural gas customers.

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

8 A. The purpose of my testimony is to address the recommendation made by Mr.  
9 Richard Thomas, a consultant who filed testimony on behalf of CMC Steel South  
10 Carolina ("CMC Steel"), that SCE&G should have used financial hedging tools to  
11 mitigate the effects of "difficult market conditions characterized by extremely  
12 volatile prices" (Thomas direct at p. 2, l. 18-19). Mr. Thomas unfairly selects  
13 historical events and therefore has the benefit of hindsight to argue that SCE&G  
14 could have saved substantial sums by using two financial hedging tools for its coal  
15 purchases, namely, financial swaps and call options. My testimony demonstrates  
16 that operating a legitimate, forward-looking, coal financial hedging program over  
17 time and not one based on pure speculation, would have likely resulted in SCE&G's  
18 customers paying more for coal purchases.

19 **Q. ARE FINANCIAL HEDGING PROGRAMS EVER APPROPRIATE WHEN**  
20 **PURCHASING ENERGY COMMODITIES?**

21 A. Yes, but the unique characteristics of each commodity market must be  
22 considered. For example, SCE&G operates a natural gas financial hedging program

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1 for SCE&G's local distribution company. Some of the factors that make a financial  
2 hedging program for natural gas feasible are: the reliance across the industry on spot  
3 market pricing, historically volatile spot market pricing, a fungible commodity and  
4 an active and liquid financial market. As discussed in Company Witnesses  
5 Haimberger and Hill's testimonies, the coal market fails to meet any of the above  
6 characteristics.

7 **Q. MR. THOMAS SUGGESTS THAT FINANCIAL SWAPS COULD HAVE**  
8 **SAVED THE COMPANY [REDACTED] IF USED IN JULY 2007 TO**  
9 **HEDGE COAL PURCHASES DURING 2008. PLEASE ADDRESS THIS**  
10 **RECOMMENDATION.**

11 **A.** In addition to the benefit of hindsight, Mr. Thomas ignores the downside risk  
12 of financially hedging coal purchases. SCE&G or anyone else executing hedges  
13 does not have this luxury. In his testimony, Mr. Thomas states that "the buyer of a  
14 swap will receive financial payment if the price of the commodity increases. This  
15 payment can be used to offset the increased price of the commodity if it is then  
16 purchased." (Thomas direct at p. 3, l. 7-10) Conveniently, and wrongly, there is no  
17 mention of who will bear the cost of the coal financial hedges if the price of the  
18 commodity decreases. The answer, of course, is SCE&G's customers would bear  
19 this risk and will pay the associated cost if the price of the commodity decreases.  
20 Also, any coal financial hedging program, if it is designed to mitigate volatility and  
21 not be purely speculative, would have to be conducted continuously because no one  
22 knows the future. With this in mind, I have set forth examples below that

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1 demonstrate what cost the customer would bear if a similar strategy to Mr. Thomas'  
2 was employed only one year later.

3 Moreover, Mr. Thomas' examples hedge 100% of SCE&G coal purchases, as  
4 he recommended hedging all projected spot purchases: "The portion of the long-term  
5 contracts due for replacement in any year and the spot purchases for that year should  
6 be hedged well before the beginning of the year" (Thomas direct at p. 3, l. 2-4). The  
7 conceptual underpinning for leaving some of a company's portfolio open to spot  
8 purchases is to give the company the opportunity to participate in lower prices if the  
9 market falls below the prices in its long-term contracts. Thus, Mr. Thomas'  
10 examples foreclose this possibility and allow for no purchasing diversity. But, of  
11 course, one should only do this if blessed with clairvoyant foresight or the ability to  
12 use hindsight as Mr. Thomas has done.

13 **Q. IS MR. THOMAS' CRITICISM THAT SCE&G COULD HAVE SAVED**  
14 **SUBSTANTIAL AMOUNTS IF IT HAD HEDGED ITS COAL PURCHASES**  
15 **IN 2007 FOR COAL TO BE DELIVERED IN 2008 FAIR AND**  
16 **REASONABLE?**

17 **A.** No, it is not. Mr. Thomas with the certainty of hindsight has conveniently  
18 selected the year 2007 in which prices were moderate and relatively stable. He then  
19 suggests that if certain financial hedging instruments had been executed in 2007,  
20 thereby hedging against the unpredictable and "difficult market conditions  
21 characterized by extremely volatile prices," savings for SCE&G customers could  
22 have been achieved. However, please consider the facts presented by Rebuttal

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1       Witness Hill, who points out in his testimony that, over the more than fifty years  
2       previous to 2007, coal prices had been relatively stable. Operating a coal financial  
3       hedging program during periods of stable prices will accomplish nothing other than  
4       to increase the total cost for coal purchases. In only three years prior to 2008 did the  
5       coal markets experience increases of greater than 5%. Witness Hill also points out  
6       that 2008 was a most difficult year for the economy at large and coal markets in  
7       particular. Thus, Mr. Thomas has unfairly selected examples with the certainty of  
8       hindsight. However, hedging programs do not operate in the past, but must be  
9       designed using proven methodology, must operate in an environment of uncertainty  
10      about future prices, and must be consistently operated over time. To suggest, as Mr.  
11      Thomas does, that SCE&G should have predicted the extremely volatile prices  
12      experienced in 2008 and should have taken action in a single year (2007) to hedge  
13      against these unforeseeable price spikes is to recommend that SCE&G engage in  
14      pure speculation.

15      [REDACTED]

16      [REDACTED]

17      [REDACTED]

18      [REDACTED]

19      [REDACTED]

20      [REDACTED]

21      [REDACTED]

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1 [REDACTED]  
2 [REDACTED]  
3 **Q. IS THERE ANY OTHER REASON WHY MR. THOMAS' CRITICISM OF**  
4 **SCE&G FOR NOT HEDGING ITS COAL PURCHASES IN 2007 IS**  
5 **INCORRECT?**

6 A. Yes, there is. Most importantly, I would note that the Commission has not  
7 authorized SCE&G to implement and operate a financial hedging program for its  
8 coal purchases. Thus, without such authorization, SCE&G would have been legally  
9 unable to hedge its coal purchases in 2007. And for the reasons stated in this  
10 testimony, SCE&G has not requested authorization from the Commission to  
11 financially hedge its coal purchases and does not seek that authority in this case.

12 Moreover, the Company is unaware of any electric utility in the southeast  
13 which currently operates a financial hedging program for its coal purchases.

14 **Q. DO YOU AGREE WITH MR. THOMAS' RECOMMENDATION MADE ON**  
15 **BEHALF OF CMC STEEL THAT SCE&G SHOULD IMPLEMENT A**  
16 **COAL FINANCIAL HEDGING PROGRAM?**

17 A. No, I do not agree. In addition to the concerns I stated previously regarding a  
18 financial hedging program for coal purchases, Mr. Thomas ignores the significant  
19 cost that is likely to be imposed upon SCE&G and its customers over time. In the  
20 past coal prices have been relatively stable, and, while 2008 was extremely volatile  
21 for coal prices, as well as many other commodities, a trend has not yet been

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1 confirmed. Thus, there is not enough history of instability in coal prices to justify  
2 implementation of a coal financial hedging program.

3 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A.** Yes, it does.